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C O N F I D E N T I A L SECTION 01 OF 02 KOLONIA 000110

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SUBJECT: CHINA SHIFTS FROM GRANTS TO LOANS IN THE FSM; OFFERS TO
REBUILD OIL STORAGE TANKS

REF: KOLONIA 103

CLASSIFIED BY: Miriam K. Hughes, Ambassador, Amembassy Kolonia,
State.

REASON: 1.4 (b), (d)

¶1. (SBU) China's Ambassador to the Federated States of Micronesia (FSM) advised that her country has recently diminished grant aid to the FSM. She claimed that Beijing was less inclined to fund her own proposals for grants and projects. Beijing believes there is little return on investment owing to poor Micronesian performance. As relations with Taiwan have begun to improve and to lessen the competitive edge in Micronesia, Ambassador Liu Fei said China had begun to focus instead on preferential loans that the Micronesians would need to repay. Chinese commercial investments were also a high priority, she said.

¶2. (C) Following a lunch at Ambassador Hughes' residence on July 23, China's Ambassador Liu Fei stayed behind for two hours to privately discuss Chinese aid activities in the FSM. Regarding the FSM's new national petroleum corporation, PetroCorp (reftel), Ambassador Liu said the FSM had turned to China several months ago to request a maintenance services agreement aimed at ensuring quality and safety standards at all four FSM state oil facilities. In response, representatives of a Chinese petroleum company came to inspect the storage tanks. Liu Fei said the Chinese specialists were appalled at the serious deterioration of the facilities, particularly in the states of Chuuk and Yap. They concluded that the tanks were beyond repair, and they declined to engage in further discussions about maintenance.

¶3. (C) Instead, China extended a concession loan offer to rebuild oil storage tanks throughout the FSM. Ambassador Liu said she believed the offer remained on the table for approximately USD 15 million. Ambassador Hughes asked whether the Micronesians would really be expected to repay such loans. Liu insisted that they had to repay and to put up collateral. For this reason, she said, this particular loan remained in abeyance. She doubted the Micronesians would be able to fulfill conditions and to obtain approval of the FSM Congress. Hughes observed that PetroCorp was advancing with almost no scrutiny from the public or the FSM Congress. She believed board members could make a deal secretly, perhaps offering land as collateral. Ambassador Liu did not discard such speculation.

¶4. (C) In the FSM state of Kosrae, Liu said Governor Weilbacher was indeed considering whether to offer property as collateral to obtain a Chinese loan to establish a cold storage plant for fish bait processing under the management of the Hong Kong based Luen Thai Company. So far, FSM Vice President Alik Alik, whose home state is Kosrae, had opposed the deal, she said. Luen Thai promised the Governor that such a plant would employ some 200 Kosraeans.

15. (C) In the meantime, Liu confirmed that Luen Thai had beat back South Korean competition and was close to concluding an agreement with Kosrae state to open a dry dock facility at the same port marina where the proposed cold storage facility would be co-located. The dry dock operation, which would require no capital investment from the Micronesians, would serve to repair and maintain a fleet of some 70 fishing vessels that Luen Thai runs in the FSM and RMI, Liu said. Together, these two projects would give Luen Thai domination of the port. Kosrae's Attorney General, who is a reliable Embassy contact, has alluded to difficult negotiations driven by the Governor. She mentioned to the Australian Ambassador that Luen Thai's chief negotiator is an American citizen named Richard Reddy, who supposedly has a criminal record for embezzlement.

16. (SBU) Ambassador Liu confirmed that China has offered a concession loan in the amount of USD 9 million for the purchase of two Harbin Y-12 airplanes, which would enable the FSM to start a new intra-island air company. Secretary of Research and Development Peter Christian has visited the airplane factory in Manchuria, and President Mori was also interested, she said. China would next try to arrange a visit of President Mori to Harbin. When Hughes questioned how the FSM would ever be able to repay a loan for the purchase of the airplanes, Liu said she did not know.

17. (SBU) Finally, Liu volunteered that in the absence of grant aid, she had invested considerable effort to try to convince Beijing to assign six Chinese doctors to work in Chuuk's state hospital. This proposal was under consideration. Liu was pleased to learn from Ambassador Hughes details of the visit of the USNS hospital ship Mercy to Chuuk, along with refurbishment of Chuuk's hospital by DOD engineers. Ambassador Liu was enthusiastic and informative, suggesting that repairs to the

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hospital, in tandem with the service of Chinese doctors, could complement our nations' joint efforts. She welcomed a suggestion to meet regularly and to schedule aid discussions that also included the ambassadors of Australia and Japan. As dean of the small diplomatic corps in the FSM, Ambassador Liu offered to host these meetings.
HUGHES